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Obama Housing Plan: What You Need to Know

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You've probably heard about the Obama administration's plan to help millions of homeowners refinance or modify their mortgages. This column is meant to answer some of your questions on whether you qualify.

The Treasury Department released the broad outlines of its plan last month, but on Wednesday provided more details about how the plan will work.

The plan's first prong may help up to five million homeowners who have been unable to refinance their mortgage because the value of their home has plunged and they now owe more than 80 percent of their home's value. To get a new mortgage, borrowers had to either bring extra cash to the table to get back to 80 percent, or purchase private mortgage insurance, which has become more difficult to qualify for and often quite expensive.

The second part of the plan may help up to three to four million borrowers modify their loans. These borrowers can no longer afford their monthly payments and are close to defaulting, while others are on the brink of foreclosure.

The administration's "Making Home Affordable" program offers mortgage providers with financial incentives to help these two groups, but to qualify, you need to meet certain requirements.

LOAN MODIFICATIONS

Q. Who is eligible?

A. The plan is only going to help those who earn enough money to pay their modified loans. So the newly jobless may not get any relief. Nor will people who overextended themselves to such a degree that there's no hope they'll ever repay their loans.

To qualify, your monthly housing payment needs to exceed more than 31 percent of your gross monthly income (that means before any payroll deductions are made). Keep in mind that your "payment" includes more than just your mortgage's principal and interest. It also includes real estate taxes, all related home and flood insurance, as well as home association and condominium fees. It does not include any second mortgages or other loans outstanding.

If your total debts, including your mortgage and any other revolving debt like credit cards, auto payments or student loans, are 55 percent or more of your gross income, you'll need to work with a counselor who has been approved by the Department of Housing and Urban Development. The modification will not take place until you sign an affidavit promising you'll get counseling.

The program applies to loans taken out before Jan. 1, 2009, but modifications can be performed now through Dec. 31, 2012. You'll only have one shot to modify your loan under the program. But people who have already modified their mortgages are still eligible, as long as they meet all of the other requirements.

Lastly, you must also live in the home; real estate investors are not eligible.

Q. Are there any restrictions?

A. Your loan amount must not exceed current Fannie Mae or Freddie Mac loan limits, which are $417,000 in most parts of the country, but up to $729,750 in higher-cost areas like New York and California. That means many people with mortgages above those limits — jumbo loans — will not receive help. Higher limits are allowed for owner-occupied properties with two to four units.

You also need to demonstrate financial hardship. That means you do not have enough liquid assets to pay your mortgage at its existing level. Your retirement assets are not included in that equation.

Q. Do I need to be behind on my payments?

A. No. If you can illustrate that your income is no longer enough to meet your mortgage payment — because your paycheck shrunk, your expenses rose or your mortgage is about to reset to a higher payment — you may qualify.

Q. Does my lender need to participate?

A. The program is expected to be widely adopted by the mortgage industry. Several of the nation's largest mortgage servicers, including Wells Fargo, Bank of America, J.P. Morgan and Citigroup, have indicated that they would participate in the program. And if a bank receives additional bailout money, it is required to take part. But that doesn't necessarily mean all participants are required to modify your loan.

What they must do, however, is examine all loans at risk of default or those at least 60 days overdue. The mortgage servicer is required to perform a calculation that will determine whether it will cost more to foreclose or to modify the loan (the servicer, lender or other owner of the loan will receive a financial incentive to modify). If the calculation shows that the modification will cost less, the lender must go ahead and modify the loan.

There may be cases where a modification is not possible. Loans that have been packaged into a security, for example, and sold to an investor that is not owned or backed by a government-sponsored entity like Fannie Mae may fall into this category. About 17 percent of mortgages fit in this category, according to Inside Mortgage Finance.

If the calculation finds that foreclosure is the most economical option, the lender must try and avert foreclosure through other means. That may be through another modification program or pursuing what's known as a short sale (when you sell the home for less than the mortgage amount and the lender forgives the difference) or a deed-in-lieu (when the borrower gives the home back to the lender without going through a foreclosure, and thus does less damage to their credit score).

Q. How will it work?

A. Your loan servicer needs to follow a series of steps to get your monthly payments to no more than 31 percent of gross monthly income. The servicer will attempt to hit this number by first reducing your interest rate to as low as 2 percent. It then has the option of extending the term of your loan by up to 40 years and deferring principal, in that order.

The interest rate reduction will remain in effect for five years. After that, your rate will gradually increase — by one percentage point each year — to the Freddie Mac Primary Mortgage Market survey rate at the time of your loan. That rate on a 30-year fixed-rate mortgage is currently 5.15 percent.

Q. What do I need to do to apply?

A. Call the company that services your mortgage.

You need to fully document your income, which includes signing an I.R.S. 4506-T form, which is a request for a transcript of your tax return. You'll also need to provide two recent pay stubs, your most recent tax return and you must sign an affidavit of financial hardship. More on that below.

Q. Are there any fees?

A. No, there are no fees. In fact, there are many scam artists out there who are promising mortgage relief. So if you've landed on a Web site or have been approached by a service that does charge a fee, that should be a red flag.

Q. What happens if I have a second mortgage?

A. All borrowers with modified mortgages who make timely payments for three months will have the opportunity to have any second mortgages forgiven. As part of the plan, the Treasury will make a cash offer to the owner of the second mortgage to forgive the debt (the amount of those cash payments has not yet been determined). The lender can refuse the offer. But the lender is likely to collect more money than if the home was lost to foreclosure, when it would receive nothing.

Q. What if my home is already in foreclosure?

A. Your mortgage servicer should halt any efforts to sell your home and see if you're eligible for a loan modification.

Q. Will the plan reduce my mortgage balance?

A. Lenders are most likely to lower your payments through other means, like lowering your interest rate. That doesn't preclude lenders from reducing your loan amount, but they aren't required to.

But there is another way to lower your balance. All borrowers who make timely payments will be able to cut their principal by up to $1,000 a year for five years. To qualify, modification must reduce your monthly payment by a minimum of 6 percent.

REFINANCING

Q. How do I know if I'm eligible?

A. Your mortgage must be owned or backed by Fannie Mae or Freddie Mac, which means jumbo loans are not eligible for refinancing. Call your mortgage servicer to find out if your loan qualifies.

You will also need to have enough income to make the new payments, and a solid payment history on your existing mortgage. So the jobless are also unlikely to qualify.

Q. What if my home is worth less than my mortgage?

A. "Underwater" homeowners may still be eligible, but your new mortgage can't exceed more than 105 percent of the property's current market value. In other words, your loan can't be 5 percent higher than your home's current value. So if you live in areas where home values have plunged the most, like Florida, Arizona or Nevada, there's a good chance you won't be eligible. According to an article by my colleague John Leland, about 20 percent of the country's 50 million mortgage holders owe more than 105 percent of their house's value.

Q. What kind of interest rate will I get?

A. All loans that are refinanced under the plan will have a 15- or 30-year term with a fixed rate, which will be based on market rates at the time of refinancing, as well as any associated points and fees charged by the lender.

Freddie Mac is waiving the extra fees that are usually levied on borrowers with riskier profiles, with the exception of a so-called market condition fee of 0.25 percentage points. If that fee is wrapped into a borrower's mortgage rate, that would increase it by about 0.05 percentage points.

Borrowers looking to refinance out of adjustable-rate or interest-only mortgages — which have lower initial payments that rise later — into a more stable fixed-rate loan, may see their payments increase. If a borrower's payment would rise by 20 percent or more, Freddie Mac will require proof of income to make sure the borrower can afford the higher payment. But those borrowers will still qualify for the going market rate.

Fannie Mae has not waived its fees. So borrowers with lower credit scores and less home equity are likely to pay more than people with a Freddie loan. For instance, borrowers with credit scores less than 620 and less than 5 percent in home equity will be subject to a fee of 3 percent of the loan amount (it can be wrapped into the interest rate).

Q. Do I need to shop around?

A. If your loan is backed or owned by Freddie, you must refinance through your current mortgage servicer. If you have a Fannie-based loan, you can comparison shop starting on April 4, but you must refinance through a Fannie-approved lender or servicer. Until then, you need to go through your existing mortgage servicer. Fannie needs some time to update its system.

Lenders may impose their own fees, so it's probably worth it to shop around. You are responsible for paying closing costs.

Q. Will I need mortgage insurance?

A. If you had mortgage insurance before, you'll keep your current insurance. But if you did not pay mortgage insurance before, you will not need to purchase it now.

Q. What if I have a second mortgage?

A. You're still eligible, but the refinancing only applies to your primary mortgage and the amount you can refinance must be less than 105 percent of your property's value. Moreover, the lender on your second mortgage has to agree to remain in a "second position," which means that if you declared bankruptcy, it would be less likely to be repaid.

Q. When can I sign up?

A. Now, though you may need to be patient as the servicers increase their staffs to handle the influx of calls. The program ends in June 2010. Call your mortgage servicer to learn more.